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SUBJECT: ENERGY: MOVING LABRADOR'S LOWER CHURCHILL PROJECT TO REALITY

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¶1. SUMMARY: Suitors have lined up for a chance to be part of the long-anticipated project to develop the hydroelectric resource of the Lower Churchill River in Newfoundland-Labrador. A tough but calculated business plan by Premier Danny Williams, coupled with new market dynamics, has economists and even the Premier's staunchest political foes predicting that it looks good for the multi-billion dollar project to proceed. Estimated output from the facility could be enough to supply 1.4 million households in eastern North America. However, until the provincial government decides on a specific marketing and transmission plan, just what portion of the output will be available for export to the United States will remain unknown. END SUMMARY

¶2. Danny Williams, the high profile premier of Newfoundland-Labrador, is once again at the forefront of another mega energy project: this time the decades-old dream of harnessing the hydroelectric potential of Labrador's Lower Churchill River (LCR). Since his election as Premier in 2003 Williams has developed a reputation as a bare-knuckled fighter for his province's economic well-being. His zealous policy of controlling development of his province's resources while maximizing economic returns has seen him take on Ottawa and win big on oil and gas royalties. However, his strong-arm tactics frustrated major oil companies in their negotiations with the Premier on a development deal for the province's fourth offshore project, Hebron, with the result that they walked away. Whether the Premier went too far in pushing the industry in the Hebron case remains to be seen. However, when it comes to the LCR project, the Premier's hard-nosed business tactics are not dissuading some high level contenders from wanting to want to work with him in moving the LCR project from a dream to a reality.

Project Specifics

¶3. To quote the Newfoundland-Labrador government's promotional literature, the Lower Churchill River is a significant untapped long-term source of clean, renewable energy available for the North American electricity market. Located 140 miles from the existing 5,428-megawatt generating facility at Churchill Falls, Labrador, the proposed project includes two potential sites. A 2,000 megawatt project at Gull Island has the potential to produce an average 11.9 terawatt-hours of energy annually. An 824-megawatt project at Muskrat Falls has the potential to produce an average 4.8 terawatt-hours per year. Combined, the projects have the potential to produce sufficient energy to supply up to 1.4 million households annually.

¶4. The cost of the project will depend on whether the Gull

Island and Muskrat Falls sites are developed at the same time (the province's preference) and how each site is configured. Because of the varying development options, analysts are looking at a broad range of total costs, falling anywhere from $6 to $9 billion. Assuming the project goes ahead, the estimated start-up date would be 2015.

Routing And Marketing Options: US Market Only One Option
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¶5. The provincial government is looking at two very different options for getting Lower Churchill's combined 2,800 megawatts of power to market. Option number one is the so-called traditional route that would see LCR power wheeled through Quebec and then to energy markets in that province, Ontario and the United States. Option number two is the Maritime route which would see the electricity moved across Labrador and then by underwater cable to Nova Scotia and New Brunswick and from there to the United States. Until those marketing options are settled, it is unclear just how much LCR power will be available for export to the United States.

Getting the Project Moving: Past and Current Attempts
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¶6. The dream to see a second hydro project in Labrador has been around for over 30 years and the province's history books show several failed attempts to get the project off the ground. Recent attempts include those proposed by Premier Williams' immediate predecessors, Liberal Premiers Roger Grimes (2002) and Brian Tobin (1998). As analysts have concluded, these previous deals were doomed to fail, principally, because they were too wrapped up in politics. The general perception in the minds of the Newfoundland-Labrador electorate was that the premiers were too quick to sell off a valuable energy resource to the only suitor, Hydro-Quebec (HQ). Also, HQ was portrayed as a bully, holding Newfoundland-Labrador ransom because it controlled the transmission lines that the LCR project would need. To add to

the contentious atmosphere, the ghost of the existing Churchill Falls contract haunted any negotiations on the LCR project. Signed in the 1960s the Churchill Falls contract allows HQ to purchase the output from the 5,428-megawatt facility at cheap rates with no escalator clauses. Several Newfoundland-Labrador premiers have tried to reopen the contract to no avail, which led them to insist on onerous conditions in a future LCR contract as a means of compensation for Churchill Falls.

¶7. Enter Danny Williams in 2003 who with his successful business background was quick to take a fresh look at the LCF project. The result was a whole new strategy featuring a pragmatic, business approach, not politics or emotions. The first notable change with the Williams' game plan was that the ghost of Churchill Falls would no longer have any influence. As Williams told Newfoundlanders and Labradoreans, "just get it over it." Also different this time is the premier's decision to have the provincially-owned utility, Newfoundland-Labrador Hydro, not politicians, on the frontlines of the process. Furthermore, the premier made another business decision by calling in some high-priced help, hiring independent industry consultants to advise the new LCR team.

¶8. By far the most radical difference from previous attempts to get the project kick-started was the Premier's move to dispel the notion that LCR could only be developed by the direct participation of HQ. Instead, the Premier embarked on an ambitious plan to see just who else might be interested in getting the project moving. What followed was his release of a competitive, five-phase strategy aimed at finding the best entity to develop the project, with no preference to any one group that might have had a past interest in the project, i.e., HQ. Phase one of the strategy was letting the world know about LCR and inviting expressions of interest. Phase two is the assessment of the different proposals. Phase three, the negotiation of commercial principles with the selected entity;

and phase four, detailed commercial negotiations.

Where we are now - Assessing the Proposals

¶9. In January 2005 the government launched Phase one by sending out individual invitations to private companies and government jurisdictions and by running ads in global business newspapers and magazines. By March 31, 2005, 25 interested parties responded. From that list, the LCR team found three development proposals to their liking and three financing options. The review team is currently crunching the numbers and finishing the risk analysis for each. Speculation is there will be a final cut by the last half of 2006.

Who Made the Cut?

¶10. The three development proponents under consideration are:

a) Hydro Quebec/Ontario Energy Financing Company/SNC-Lavalin. Hydro Quebec is owned by the government of Quebec; Ontario Energy Financing Company is one of the five components established by the restructuring of the former Ontario Hydro; and SNC-Lavalin is a privately owned engineering and construction company.

b) TransCanada Corporation, a publicly traded North American energy company, headquartered in Calgary.

c) The Tshiaskueshish Group, a consortium comprised of Australian, Canadian and First Nation business interests in Labrador.

The three financial proponents are:

a) Cheung Kong Infrastructure Holdings Limited, a Hong Kong diversified infrastructure company.

b) Borealis Infrastructure Management Inc. a subsidiary of the Ontario Municipal Employees Retirement System, one of Canada's largest pension plans.

c) Altius, a Newfoundland and Labrador based royalty and mineral exploration investment company focused on resource development in Newfoundland and Labrador.

The Other Contender - The Newfoundland-Labrador Government
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¶11. Consistent with his government's policy of maintaining control over the province's resources and maximizing economic returns, the Premier also has another option, going it alone.

The Premier's thinking is if the 25 interested parties who bid on the project believe they can develop it, there is no reason why the Newfoundland-Labrador government cannot do the same. With the money from the new offshore royalty agreement, the Premier believes this cash provides the province with the required leverage in dealing with any potential developers or financial partners in a Newfoundland-Labrador led project. To let all the parties know that the Williams government is serious in its intent to be an equal contender, it formally applied to Hydro Quebec's transmission division for approval to wheel the LCR power through its transmission system. The province has already made a refundable deposit of $17 million, which presents an estimate of one-month tariff for using HQ infrastructure through its Open Access Transmission Tariff. At present, HQ is studying the application, but will have to come up with a response at some point.

Comment: Is It Really LCR's Day In The Sun?

¶12. With a number of serious propositions on the table and a

changed energy market which now favors new, clean power sources like the LCR, many economists, joined surprisingly enough by the Premier's political foes, believe it is time for LCR's day in the sun. Moreover, the Premier's steadfast business approach should mean that the province can get the most realistic and cost-effective development plan possible. While finding an interested party now appears likely, there are still several hurdles to overcome before the project can move ahead. The premier has been very forthright in discussing what these are: environmental and aboriginal issues and equally important, national political considerations. A specific issue will be to determine just what role the new Harper government may play in the project.

¶13. Considering the Premier's record of never shying away from a battle, he will be looking to Ottawa for such things as loan guarantees or other forms of financial involvement. However, just how interested the Conservative government in Ottawa will be in helping to finance a project where the bulk of the power might leave the country, remains to be seen. While these considerations will be complicating factors further down the road, for now the Premier and his LCR team are focused on the immediate task of reviewing the different proposals. Once that is completed, then the next battle starts: Premier Williams going head to head with a would-be developer in the commercial negotiations of Phase three. Given his tenaciousness as a negotiator, our money is on Williams to take every possible nickel off the table. END COMMENT
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